TESTIMONY OF

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INTERNATIONAL AND REGULATORY AFFAIRS,

UNITED AIRLINES

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U.S. - E.U. Open Skies Agreement: with a focus on DOT's NPRM regarding 'actual control' of U.S. air carriers

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Mr. Chairman, Members of the Committee, thank you for the opportunity to present the views of United Airlines on reducing regulatory barriers and expanding investment opportunities for U.S. and foreign carriers in the global aviation market. While we acknowledge the concerns of some of our colleagues and competitors in the U.S. aviation sector, as the nation's largest international airline, we take a very different view – one we believe is shared with many, if not most, U.S. aviation interests.

We applaud the dedicated and sustained work of the Departments of Transportation (DOT) and State (DOS) to reduce barriers to international aviation. Through several Administrations, Republican and Democratic, both Departments have made great strides in opening international aviation to market forces and eliminating anachronistic regulatory barriers to trade and competition. Over the last 15 years, the Departments of Transportation and State have led a remarkably successful global campaign for open skies -- enabling U.S. and foreign airlines to traverse the globe with increasingly fewer restrictions on where, when, and how often they can fly, what they can charge, or how they can market their international services.

The proposed rulemaking on investment that is the subject of today's hearing represents another step – if only a limited one – in the same right direction. Indeed, we would prefer that the U.S. go further and, on a reciprocal basis with other key aviation countries, eliminate all constraints on foreign ownership and control, except only as they relate to national security oversight.

Restricting cross-border investment in the airline sector is one vestige of a pre-deregulation mindset that continues to inhibit U.S. aviation, treating it differently from virtually any other U.S. industry in the global economy. The same approach gave rise to the largely now-forgotten government restrictions on routes, pricing, marketing, and other services that beset the U.S. industry for a half century, from the inception of commercial aviation to its deregulation in 1978. Indeed, the so-called “foreign ownership” rule itself originated in the Commerce Act of 1926 -- before Lindbergh’s transatlantic solo flight, and well before the development of any significant U.S. commercial airline industry.

Rather than labor under these anachronistic government economic constraints, U.S. airlines should be allowed to function just like other global businesses, driven by the dictates of a free market, not government economic edict. In a world where our international passengers can readily access their multinational bank accounts, stay in international hotel chains, and connect with worldwide communications networks on a global basis, it makes little sense for U.S. international airlines -- the quintessential infrastructure of the global marketplace -- to stay bound by restrictions of a bygone era.

U.S. airlines have undergone tremendous financial stress over the last five years, and it is hardly necessary to recite the litany of woes – from SARS to fuel costs to terrorism – that have beset nearly every major airline. But numerous U.S. airlines have proven far more resilient than some predicted.

At United, we have just come through a complex and difficult bankruptcy – one of the largest ever in the U.S. The process required contributions by and adjustment for thousands of employees and business partners across the country. We have emerged, though, with a new sense of optimism. Our unit costs have dropped by 20 percent, excluding fuel, and we anticipate an annual average cost savings of $7 billion through 2010. We have also increased productivity by 27 percent, reducing duplication and waste. Today we are confident in our ability to compete effectively and efficiently not only throughout the U.S., but also in the critical international arena.

Let me stress, Mr. Chairman, that we are intensely focused on competing, expanding, and succeeding in that international marketplace. Compared to the relatively mature U.S. domestic market, the demand for international air service is rapidly accelerating. While North America's share of world air traffic is projected by Boeing to shrink from 25 percent to 20 percent over the next two decades, the share of intra-Asia markets will grow from 16 percent to 20 percent. And while domestic air traffic is forecast to grow only 3.5 percent annually during that period, transatlantic traffic is projected to grow by 4.6 percent annually, while traffic to Southeast Asia and China jumps every year by 7.3 percent and 8.0 percent respectively -- more than double the rate of North American growth.

It is not just that international markets are growing faster than the domestic market that leads us to focus on international service; it is also the fact of our growing competitive strength in those foreign markets. Where United once significantly lagged its European competitors in operating and cost efficiency, today we have achieved a vastly improved competitive position in important transatlantic markets. With these factors in mind, we have greatly expanded United international services over the last three years. Not only have we begun service to 12 new foreign cities, we have increased the number of foreign routes we serve by 44 percent and our overall international departures by 31 percent, and hope to expand in other international growth markets, including in China.

Simply put, we at United are looking for opportunities to compete in an open international aviation market -- not for regulatory protection from foreign competition or foreign investment. In the long run, the enduring path to aviation industry success is to become more competitive, embracing opportunities for international growth, integration, and inter-carrier cooperation and consolidation, including through investing in foreign carriers.

Historic U.S. leadership of global aviation -- and scores of other global industries -- is built on forward-looking, risk-taking competitive zeal, not on economic protection of U.S. flag companies. Removing constraints on cross-border investment and ownership limits may remove a degree of economic protection of U.S. firms and interests, but it also unleashes U.S. competitive strengths and entrepreneurial resilience. This trade-off, reflected in DOT's proposal, remains the philosophical basis for bipartisan liberal U.S. trade policy.

Today, U.S. leadership of international aviation – virtually unchallenged since the dawn of commercial flight – is seriously threatened. The world's largest airline by revenues is no longer a U.S. airline, but rather the Air France/ KLM combination in Europe. Similarly, U.S. carriers are no longer the major purchasers of long-haul aircraft, but rather lag far behind their Asian and European competitors in the acquisition of the newest technologically-advanced long-haul jets. In fact, no U.S passenger airline has committed to purchase the super-jumbo Airbus 380, and only a very few high-efficiency Boeing 787 or Airbus 350 aircraft have been ordered by U.S. carriers.

Mr. Chairman, in today's competitive international airline industry, we think the only path that makes sense is the one that leads toward full deregulation, and the elimination of restrictions that continue to hold back U.S. carriers. DOT's rulemaking proposal is a good one, as far as it goes, as it would open investment opportunities for competitive U.S. carriers, while also enabling greater integration of U.S. airlines with their foreign carrier partners. At the same time, it respects the U.S. statutory foreign share ownership and governance requirements and responds to concerns about U.S. safety, security, and Civil Reserve Air Fleet (CRAF) needs.

More open foreign investment opportunities will also benefit international air travelers, who today already enjoy the benefits of inter-airline integration provided by the global airline alliances. Today, our Star Alliance joins together 16 global airlines in the largest international air carrier network. This Alliance offers passengers from across the globe a significantly more seamless international travel experience – through more convenient connecting flights on multi-segment journeys, common airport lounge facilities, reciprocal frequent flyer programs, coordinated and proximate gate locations, one-stop ticketing on multi-carrier trips, and other services and conveniences. DOT has repeatedly acknowledged the importance of these significant, alliance-related consumer benefits.

Expanded foreign investment opportunities made possible by the DOT proposal would enhance the scope and level of this consumer-friendly inter-carrier integration. Specifically, it would enable airlines to take today's alliance-based inter-airline integration to the next level by facilitating cross-carrier equity investment and participation in business decision-making. Such investment and financial commitments would cement and strengthen the inter-carrier relationships that today rest solely on contractual agreements, albeit in some cases enhanced by DOT-granted antitrust immunity.

U.S. communities would also benefit from a more open investment regime, as strategic investment could support struggling U.S. carriers and associated jobs. And, while the proposed rule stands on its own merits, it is also a fact that our European aviation partners view the proposed investment liberalization as a sine qua non of any open market transatlantic agreement. Such a US-EU agreement, the text of which has already been negotiated, would bring new competitive service options for many U.S. cities seeking transatlantic service, since it would enable any EU carrier to serve any U.S. city, regardless of its country of origin, just as any U.S. carrier could serve any EU city. Not surprisingly, the Airports Council International North America– the major U.S. body for airports – has strongly endorsed the DOT proposal.

From the U.S. airline perspective, the proposed DOT rule would encourage all-important <u>strategic</u> investment in U.S. airlines. U.S. carriers already appear to have adequate access to capital through investments from venture capital and hedge funds, and from private investors attracted by the industry's depressed valuations. The recent and rapid subscription of United's post-bankruptcy financing by major financial players reflects this availability, as does the financing readily provided to US Airways as it emerged from bankruptcy earlier this year.

But the proposed DOT rule would encourage long-term, strategic investment from those interested in building and maintaining airline businesses, not just transitory investment gains. This kind of strategic industry investment – whether by foreign investors in the U.S. or by U.S. airlines in foreign carriers – can play an important role in stabilizing the volatile airline sector.

Substantial cross-investment among international airlines can enable carriers in one region to broaden their financial exposure to other regions where growth and demand may be relatively strong – and so help flatten the often drastic and cyclical peaks and valleys of airline operations and profitability. Conversely, global equity-based financial exposure can help spread risk – and so avoid the potential catastrophic impact of what has become for aviation the expectation of the unexpected – from SARS to terrorism to avian flu. Strategic cross-border investment can also help normalize the structure of the airline industry, eliminating some of the inefficient and destructive fragmentation of the international airline market.

Mr. Chairman, while the DOT investment initiative has merit on its own, it should also be considered in the broader context of the pending agreement that would create a full open skies aviation market between the U.S. and Europe. As noted earlier, the Europeans make no secret of the fact that they view relaxation of airline investment restrictions as essential to such an agreement. While we would not support a bad DOT policy rule simply to gain European approval of the pending agreement, we do wish to make clear that we endorse the US-EU agreement. We do so in light of the open skies and operational flexibility benefits the agreement would offer the U.S. and our airline – even though it will also expose United to significant new competition from major European airlines, as well as from U.S. competitors on certain key routes.

The proposed US-EU agreement would enable any European airline, regardless of its nationality, to fly to anywhere in the U.S. from any city in Europe, not just from the airline's homeland. Together with the new investment rules, this agreement will mean more competition for United – including in particular more competition from foreign airlines serving key U.S. markets from London's Heathrow airport. A new transatlantic open market agreement would also open Heathrow service to other U.S. airlines as a matter of law. Recognizing that reality, United is prepared to accept this commercial challenge and pay this competitive price because, in the long run, we will only succeed if we can compete in a truly open global market. United and other U.S. airlines can do so, and can reassert U.S. aviation leadership, but only if we are prepared to compete efficiently and effectively as normal businesses on a global playing field.

To be frank, Mr. Chairman, we are surprised at the degree of concern that this relatively modest DOT proposal appears to have generated. Looked at closely, it is essentially an incremental step – albeit an important one -- along an extended path to a fully-deregulated, market-based, global industry. The proposal does nothing to affect the actual foreign ownership statutory requirements – that U.S. citizens own 75 percent of voting stock and serve as President and two-thirds of every U.S. airline's Board and managing officers; rather, it would relax only the interpretation of the regulatory control requirement.

And of course foreign investment liberalization is itself only a small part of a broader and essential deregulation agenda that DOT has pledged to pursue. In that vein, we appreciate the Department's recognition that airline deregulation is still unfinished business -- a work in progress, and we strongly urge it to maintain its focus on achieving the many critical, remaining deregulation goals.

Given the circumscribed nature of this foreign investment regulatory step, it is regrettable that some have chosen to mount such high-pitched opposition to it. DOT's critics focus on exaggerated fears of foreign investment in the U.S., while virtually ignoring the benefits of U.S. investment in foreign airlines, and the broader benefits of showing consistent support for open aviation markets, free trade, and investment freedom. Regrettably, these objections are not entirely unexpected. Virtually every significant step toward aviation liberalization has met unwarranted opposition – from the 1978 deregulation of the U.S. domestic industry, to the pursuit of global open skies policy more than a decade later.

The DOT proposal to facilitate cross-border airline investment within the limits of the current statute, together with the transatlantic open market agreement it will encourage, signals a hopeful new direction for U.S. and international aviation – and one that will work to the benefit of a resilient U.S. airline industry. Especially as the proposal moves toward freeing airlines from anachronistic marketplace distortions, and in the direction of enabling U.S. airlines to compete like other global businesses, it can help bring about a more fully deregulated environment in which U.S. carriers can regain their historic global aviation leadership.

Thank you again for the opportunity to appear and present the views of United Airlines. I would be pleased to respond to any questions of the Committee.